

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:FIP:02

PLR-148474-05

Date:

August 17, 2006

Legend

REMIC =

EIN:

Borrower =

Original Lender =

Loan =

Note =

\$X =

Y Percent =

Date A =

Date B =

Date C =

State A =

Dear :

This responds to a letter dated September 20, 2005, and subsequent correspondence submitted on behalf of REMIC, requesting that the Internal Revenue Service rule that the modification of the Loan in the manner described below will not prevent: (1) the Loan from continuing to qualify as a qualified mortgage under section 860G(a)(3) of the Internal Revenue Code (the "Code"); and (2) the release of the lien on real property securing the Loan from meeting the requirements of section 1.860G-2(a)(8) of the Income Tax Regulations (the "regulations").

Facts

Borrower is organized as a State A limited liability company. Borrower and Original Lender entered into the Loan as a nonrecourse obligation on Date A in an original amount of \$X. The Note evidencing the Loan provides for an annual interest rate of Y Percent and an original maturity date of Date C.

Borrower's performance of its obligations under the terms of the Loan is secured by commercial real estate. Borrower desires to obtain a release of the lien of the mortgage on the real estate securing the Loan in order to facilitate the disposition of the real property or another customary commercial transaction.

Under the terms of the Note, Borrower has the right at any time on or after the later of (i) Date B or (ii) two years and one day from the "start up day" of REMIC, to exercise a defeasance option permitting Borrower to obtain a release of the real property from the lien of the mortgage securing the Note.

Under the terms of the Note, in connection with Borrower's exercise of the defeasance option, Borrower is required to deliver, as substitute collateral for the Note, government securities which provide for payments which are payable on or prior to, but as close as possible to, all successive monthly payment dates under the Note that arise after Borrower obtains a release of the real property securing the Note. Borrower desires to modify the terms of the Note to remove the requirement that the government securities mature as close as possible to the successive monthly payment dates under the Note so that Borrower is free to acquire and use in structuring its substitute collateral portfolio, any government security so long as such government security continues to satisfy the other requirements of the Note. REMIC represents that in no event will it permit Borrower to pledge, as substitute collateral in connection with the exercise of the defeasance option, any government security maturing more than twelve (12) months prior to a respective government security's associated principal and interest payment obligation due under the Note.

Law and Analysis**A. Treatment of proposed modification of Loan under section 1001**

Section 1001(c) of the Code provides that the entire amount of gain or loss on the sale or exchange of property shall be recognized, except as otherwise provided. Section 1.1001-1(a) of the regulations states in pertinent part that the gain or loss realized from the exchange of property for other property differing materially either in kind or in extent is treated as income or as loss sustained.

Section 1.1001-3 of the regulations provides rules for determining whether a modification of the terms of a debt instrument results in an exchange for purposes of section 1.1001-1(a) of the regulations. Under the general rule set forth in section 1.1001-3(b) of the regulations, a significant modification of a debt instrument results in an exchange of the original debt instrument for a modified instrument that differs materially either in kind or in extent from the original debt instrument.

Section 1.1001-3(c)(1)(i) of the regulations defines a modification as any alteration, including any deletion or addition, in whole or in part, of a legal right or obligation of the holder or issuer of a debt instrument, whether the alteration is evidenced by an express agreement (oral or written), conduct of the parties, or otherwise.

Except as provided in paragraphs (e)(2) through (e)(6) of section 1.1001-3 of the regulations, a modification is a significant modification under the general rule of paragraph (e)(1) of section 1.1001-3 only if, based on all facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered are economically significant. Paragraphs (e)(2) through (e)(6) of section 1.1001-3 of the regulations set forth specific rules under which a modification is classified as a significant modification. Paragraph (f) of section 1.1001-3 of the regulations requires a determination of whether a modification of any term is a significant modification under each applicable rule in paragraphs (e)(2) through (6) of section 1.1001-3. Paragraph (e)(4) of section 1.1001-3 is applicable to this case.

Under paragraph (e)(4)(iv)(B) of section 1.1001-3 of the regulations, a modification that releases, substitutes, adds or otherwise alters a substantial amount of the collateral for, a guarantee on, or other form of credit enhancement for a nonrecourse debt instrument is a significant modification. Paragraph (e)(4)(iv)(B) of section 1.1001-3 further provides, however, that a substitution of collateral is not a significant modification if the collateral is fungible or otherwise of a type where the particular units pledged are unimportant (for example, government securities or financial instruments of a particular type and rating).

The proposed modification described above alters the legal rights of the issuer and holder of the Note and thereby effects a modification of the debt instrument under section 1.1001-3(c)(1)(i) of the regulations. However, because the proposed

modification would only permit Borrower to substitute government securities for other government securities to be used as substitute collateral in a defeasance of the Loan, the proposed modification does not constitute a significant modification under section 1.1001-3(e)(4)(iv)(B) of the regulations.

B. Treatment of release of real property lien under section 860G

Section 860D(a)(4) of the Code defines a REMIC in pertinent part as an entity substantially all of the assets of which consist of qualified mortgages and permitted investments as of the close of the third month beginning after the startup day and at all times thereafter. Section 860G(a)(3)(A) requires that an obligation be principally secured by an interest in real property to be considered a qualified mortgage. Section 860G(a)(3)(A) also requires that an obligation be transferred to the REMIC on the startup day in exchange for regular or residual interests in the REMIC or be purchased by the REMIC within the 3-month period beginning on the startup day to be considered a qualified mortgage.

Section 1.860G-2(a)(8) of the regulations provides that a mortgage ceases to be a qualified mortgage if a REMIC releases its lien on real property that secures it unless certain requirements are met. The requirements set forth are: (i) the mortgagor must pledge substitute collateral that consists solely of government securities (as defined in section 2(a)(16) of the Investment Company Act of 1940 as amended (15 U.S.C. 80a-1)); (ii) the mortgage documents must allow such a substitution; (iii) the lien must be released to facilitate the disposition of the property or any other customary commercial transaction, and not as part of an arrangement to collateralize a REMIC offering with obligations that are not real estate mortgages; and (iv) the release must not be within 2 years of the startup day.

It is represented that the proposed defeasance transaction satisfies the requirements of clauses (i), (iii), and (iv) of section 1.860G-2(a)(8) of the regulations. At issue is whether the proposed modification of the Loan prevents the transaction from satisfying the requirement of clause (ii).

Section 1.860G-2(a)(8) of the regulations is an anti-abuse provision aimed at the prevention of the collateralization of a REMIC with obligations that are not qualified mortgages, required under section 860G(a)(3)(A) of the Code to be obligations principally secured by an interest in real property. Where, as a part of a transaction otherwise meeting the requirements of section 1.860G-2(a)(8), the terms of the Note are to be modified under the specific circumstances in which (1) the terms of the Note, before modification, allow the Borrower to pledge substitute collateral described in section 1.860G-2(a)(8)(i), (2) the terms of the Note, after modification, also allow the Borrower to pledge substitute collateral described in section 1.860G-2(a)(8)(i), (3) the modification of terms of the Note is not a significant modification for purposes of section 1001 and regulations under that section, and (4) the modification of the terms of the

Note is not inconsistent with the anti-abuse purpose underlying section 1.860G-2(a)(8), the modification does not prevent the transaction from satisfying the requirement of clause (ii) of section 1.860G-2(a)(8).

Rulings

Based on the facts as represented, we rule as follows:

(1) that the proposed modification of the Loan held by REMIC will not prevent the Loan from constituting a qualified mortgage within the meaning of section 860G(a)(3) of the Code if, under the described facts, the terms of the Note are modified to remove the requirement that the government securities mature as close as possible to the successive monthly payment dates under the Note; and (2) that the proposed modification of the Loan in the manner herein described will not prevent the release of the lien on the real property securing the Loan from satisfying the requirement of clause (ii) of section 1.860G-2(a)(8) of the regulations.

Except as specifically ruled upon above, no opinion is expressed or implied regarding the federal tax consequences of the described transaction. No opinion is expressed as to whether REMIC otherwise qualifies as a REMIC under sections 860A through 860G of the Code. Furthermore, no opinion is expressed whether the proposed defeasance transaction satisfies the remaining requirements of clauses (i), (iii), and (iv) of section 1.860G-2(a)(8) of the regulations.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter should be attached to the federal income tax return of REMIC for the taxable year in which the Loan is modified and the mortgage lien is released.

In accordance with the provisions of a power of attorney currently on file, we are sending a copy of this ruling letter to your authorized representatives.

Sincerely,

William E. Coppersmith
Chief, Branch 2
Office of Associate Chief Counsel
Financial Institutions & Products)